IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF ALABAMA
SOUTHERN DIVISION

UNITED STATES OF AMERICA,

v.

Case No. CR-03-BE-0530-S

RICHARD M. SCRUSHY,

Defendant.

DEFENDANT'S MOTION TO MODIFY THE COURT'S
RESTRAINING ORDER DATED NOVEMBER 3, 2003

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Defendant Richard M. Scrushy respectfully submits this motion to modify the restraining order dated November 3, 2003 (the "Restraining Order") so as to release those assets not properly restrained.

PRELIMINARY STATEMENT

In its zeal for media attention in this era of corporate scandal, and the tactical advantage gained by depriving Mr. Scrushy of access to his assets prior to trial, the Government has sought and obtained provisional relief far in excess of what the law allows. The applicable statutes and the prevailing caselaw permit the Government to restrain, prior to a conviction, a defendant's assets as to which it (relying on a grand jury indictment or by making its own showing) could make a probable cause finding were the proceeds of illegal activity or "involved in" the alleged fraud and thus forfeitable. However, the Government may not restrain assets that are unenumerated in an indictment or for which it could not otherwise make a probable cause finding. And, enumerated or

not, the Government may not restrain, pre-conviction, substitute assets in the place of potentially forfeitable assets that might have been spent or that will be unaccounted for at the end of the trial.

Here, the Government sought and received a Restraining Order that interferes with Mr. Scrushy's use of and access to all of his assets, despite the uncontested fact that he accumulated many millions of dollars in assets both (1) prior to the time frame of illegal activity alleged in the indictment and (2) during the time period alleged in the indictment but from sources unrelated to the alleged illegal activity. For these reasons, the Restraining Order must be modified to lift the restrictions on Mr. Scrushy's access to his improperly restrained assets.

PROCEDURAL HISTORY

The procedural history of this case long predates the return of the indictment against Mr. Scrushy (the "Indictment"). As set forth in the Memorandum Opinion of the Honorable Inge P. Johnson ("Judge Johnson") dated May 7, 2003, the Securities and Exchange Commission (the "SEC") filed a complaint against Mr. Scrushy on March 19, 2003 (the "SEC Complaint") along with a petition for emergency relief freezing all of his assets. SEC v. HealthSouth Corporation, 261 F. Supp. 2d 1298, 1301 (N.D. Ala. 2003). The SEC Complaint alleges, *inter alia*, that Mr. Scrushy orchestrated a broad-based conspiracy to inflate the operating results and financial condition of HealthSouth. Id. at 1302. The SEC sought the disgorgement of Mr. Scrushy's alleged ill-gotten gains from the fraud. Id. The Court issued a temporary restraining order and held an 11-day hearing regarding the SEC's effort to convert the temporary restraining order into a preliminary injunction. In her memorandum opinion dismissing the asset freeze, Judge Johnson held that "evidence of Scrushy's involvement in the alleged scheme to inflate profits to meet

Wall Street expectations is lacking." Id. at 1318. Judge Johnson further held "defendant Scrushy *proved* that at least 49 million dollars of his assets since 1993 are not derived from HealthSouth income, bonus or stock." Id. at 1315 (emphasis added).[1]

Almost six months passed since Judge Johnson issued her memorandum opinion. During this time, Mr. Scrushy enjoyed free and unfettered access to and use of his assets. The Government has not and cannot allege that Mr. Scrushy wasted, dissipated or concealed his assets during this period, although he had every right to do so.

The Indictment was returned under seal on October 30, 2003 and the Restraining Order was entered by this Court on November 3, 2003. On November 4, 2003, both the Indictment and the Restraining Order were served upon the Defendant along with search warrants and writs of entry for Mr. Scrushy's properties.

The Indictment alleges that, beginning in 1996, Mr. Scrushy engaged in a conspiracy to inflate the financial condition of HealthSouth and acquired property in the aggregate sum of $278,727,647.35 as the result of that conspiracy. Indictment, Count 71, p.34. The Indictment enumerates various asset purchases that are alleged to be traceable to proceeds derived from unlawful activity or property "involved in" the offense charged, and are therefore potentially forfeitable upon a conviction on the underlying offenses. Indictment, Counts 71 to 85, pp. 33-38. Presumably, the grand jury reached a probable cause finding that the assets specifically identified in the Indictment are subject to forfeiture. However, many of these assets cannot properly be restrained because they were acquired by Mr. Scrushy prior to the period of criminal activity alleged in the Indictment.

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[1] As set forth in Point II.D.1, *infra*, this finding by a federal court in a proceeding in which the Government raised the issue and in which the Department of Justice specifically intervened is now binding on the Government here.

In addition to effecting a pre-conviction freeze of the assets that the grand jury found to be forfeitable, the Restraining Order issued by the Court also restricts Mr. Scrushy's use or sale of an additional 33 pages of assets which were *not* presented to the grand jury and therefore do not enjoy the procedural benefits of a grand jury's probable cause findings. As will be set forth more fully herein, the Restraining Order enjoins Mr. Scrushy's use of significant assets that are unrelated to the time period or substantive allegations set forth in the Indictment.

During the three weeks since the Indictment and Restraining Order were served, Mr. Scrushy has tried in vain to negotiate with the Government to obtain a release of the assets that have been improperly restrained. The Government has not set forth any legal basis for restraining untainted assets before conviction, and the offers of a non-litigated resolution it has made are grossly inadequate, thus necessitating this motion.

ARGUMENT

I. In A Pre- or Post-Trial Setting, the Government May Only Interfere With A Defendant's Property Interests Pursuant To Express Statutory Authority

As a basic starting point, the Supreme Court has recognized that a person has the right to enjoy his or her property as a basic protection of the Constitution. Due Process requires that a person not be deprived of property without notice and an opportunity for a hearing "at a meaningful time and in a meaningful manner." Fuentes v. Shevin, 407 U.S. 67, 80 (1972). Any deprivation of a basic property interest or right may only occur if there has been due process of law. Id. at 81.

The Court has held that Congress has the power to create the means for the Government to interfere with a person's enjoyment of his property in the context of the freezing of assets as part of a criminal investigation or criminal proceeding. See Caplin

& Drysdale, Chartered v. United States, 491 U.S. 617, 627-28 (1989). However, because this interference conflicts with constitutional property rights, the Government's power is carefully circumscribed. The Government must steadfastly adhere to the specific powers conferred by statute and must comply with the procedures enumerated in the court opinions elucidating those statutory provisions. See, e.g., Grupo Mexicano de Desarrollo, S.A. v. Alliance Bond Fund, Inc., 527 U.S. 308 (1999); United States v. James Daniel Good Real Property et al., 510 U.S. 43, 61-62 (1993); United States v. Monsanto, 924 F.2d 1186 (2d Cir. 1991), on remand from 491 U.S. 600 (1989).

Consequently, the Court will tolerate Government interference with a defendant's property in an asset forfeiture setting only if the Government seeks that which the law has allowed it to obtain and only if the Government utilizes the proper procedures in effecting this interference.

In the general scheme allowed by statute, the Government may seek to "freeze" a set of assets and property owned by an individual under the theory that the asset or property represents the proceeds of a specified set of criminal charges, or was "involved in" the offense, such as racketeering, fraud, engaging in a continuing criminal enterprise, or money laundering. See 18 U.S.C. §§ 981(a)(1)(C), 982, and 1963; 21 U.S.C. § 853; 28 U.S.C. § 2461. Each of these statutes follows the same basic structure of allowing the Government to obtain forfeiture at the end of its case, when it has proven the charges filed, of the assets or property that were found to be the "fruits" of or "device" by which the criminal conduct occurred. 21 U.S.C. § 853(a). Seizure or restraint in a forfeiture case is premised on the notion that ill-gotten gains did not belong to the defendant in the first place and that his unrestricted possession of the property could result in its loss or

destruction. In order to avoid the dissipation or secretion of assets which are directly related to the charged criminal conduct, the statutes then take one step backwards to allow the Government, if it uses the proper methods, to ask a court to restrain any of those specifically defined, criminally-derived assets or property (often called "tainted" assets) prior to a final judgment or verdict in order to ensure that those assets will be there for the Government to seize once the case is completed. The keystone to all of these asset forfeiture provisions is the fundamental requirement that the Government properly allege and make a proper showing that the specific asset or property involved can be traced to or is clearly derived from the alleged wrongdoing. See Monsanto, 924 F.2d at 1196.

What no statute allows, and what courts have routinely forbidden, is for the Government to try to take two steps backwards from its final verdict or judgment to restrain a person's assets that were not the fruits of a crime or derived from the alleged criminal conduct. In other words, the law does not confer upon the Government any pre-trial right to impair a person's right to possess or use those assets which have nothing to do with the Government's allegations of wrongdoing. Again, in the statutory scheme, the Government may only seek the forfeiture of these untainted assets or property when they are considered to be "substitute assets." And "substitute assets" are specifically defined as those which come into existence only after the Government has proven its case and obtained its judgment and is unable to take possession of the forfeited asset due to an act or omission on the part of the defendant. See, e.g., 21 U.S.C. § 853(p). Before that time comes, there is no provision to allow the Government to seize or otherwise interfere with

such a "substitute" asset, because doing so would conflict with basic property rights and due process protections.

Were the Government to interfere with the set of assets and property for which there was no claim of a criminal connection prior to the time that a substitution right can be employed, any number of other constitutional protections would be violated, including the right not to be subject to unreasonable searches and seizures, see Johnson v. United States, 333 U.S. 10, 13 (1948), and a person's right to use his or her own property to secure counsel of his choice. See Monsanto, 924 F.2d at 1203; In re Account Nos. Located at Bank One in Milwaukee, Wisconsin, 9 F. Supp. 2d 1015, 1017 (E.D. Wis. 1998).

Thus, the forfeiture laws and the judicial interpretations of those provisions must be strictly followed and enforced to avoid infringing on the constitutional rights a person enjoys to his own assets and property.

II. The Government Has Improperly Restrained Mr. Scrushy's Assets By Failing To Follow Statutory Authority

By failing to distinguish between the rights it has before an indictment is returned and those that it has after charges are brought, and by failing to distinguish between "tainted" assets, "untainted" assets and "substitute" assets, the Government has imposed an unconstitutional restraint on Mr. Scrushy's property.

A. There Is No Statutory Basis For Post-Indictment Restraint Of Assets Not Specifically Enumerated In The Indictment

The allegations in both forfeiture counts of the Indictment are governed by the general criminal forfeiture statute found in 18 U.S.C. § 982. Section 982(b)(1) provides that the procedural provisions of the Comprehensive Drug Abuse Prevention and Control

Act of 1970 govern with regard to the procedure to be utilized in this case. See 21 U.S.C. § 853 ("Section 853").

Section 853(e) provides the Government with two means to obtain a restraining order or injunction in order to preserve, prior to trial, the availability of a defendant's property that may be subject to forfeiture after conviction. Section 853(e)(1)(A) provides for the post-indictment, pre-conviction restraint of assets specifically alleged to be forfeitable in the operative indictment. Section 853(e)(1)(B) provides for the restraint of assets *prior* to the filing of an indictment (i.e., not specifically alleged to be forfeitable in an indictment) after notice and a hearing if the Government can show that (i) there is a substantial probability that the Government will prevail on the issue of forfeiture and that failure to enter the order will result in the property being destroyed, removed from the jurisdiction of the court or otherwise made unavailable for forfeiture; and (ii) the need to preserve the availability of the property outweighs the hardship to the defendant whose property is being restrained. As the result of this statutory scheme, the Government has two ways to restrain assets pre-judgment -- either by specifically identifying the assets to be restrained in an indictment or by meeting its probable cause burden at an adversary hearing prior to the issuance of an indictment.

Here, the Restraining Order encumbers not only the assets specifically enumerated in the Indictment but also a thirty-three page list of assets ("Attachment 1") that are not set forth in the Indictment. As to the latter group of assets, there is no statutory basis for pre-trial restraint once an Indictment has been sought. There is good reason for this. Section 853(e)(1)(B) assumes that the assets to be restrained will ultimately be enumerated in an indictment. In fact, as the statute itself states, an order

entered pursuant to Section 853(e)(1)(B) only remains in effect for ninety days, unless extended by the court for good shown or unless an indictment or information has been filed. Moreover, Section 853(e)(2) provides that a temporary restraining order may be issued under Section 853(e)(1) when an indictment has not yet been filed with respect to the property only upon a showing that "there is probable cause to believe that the property with respect to which the order is sought would, in the event of a conviction, be subject to forfeiture under this section," i.e., ultimately enumerated in an indictment. To permit the Government to restrain, post-indictment, assets that are not enumerated in the indictment would render Section 853(e)(1)(A) a nullity.

So, as a threshold matter, the Government has improperly merged different, mutually exclusive provisions of the forfeiture statute to effect its illegal seizure of Mr. Scrushy's property. In addition, whether the Government proceeded correctly under 853(e)(1)(A) or incorrectly under 853(e)(1)(B), it may still only restrain before trial that which it can show it had a proper basis to encumber.

B. Mr. Scrushy Is Entitled To An Adversary Hearing In Which The Government Must Meet Its Burden Of Demonstrating Probable Cause To Restrain His Assets

As a threshold matter, even if this Court somehow finds that the Government may restrain, post-Indictment, assets not specifically enumerated in the Indictment, such restraint could only have been imposed "after notice to persons appearing to have an interest in the property and opportunity for a hearing." Section 853(e)(1)(B). No such hearing was held here. While having such a hearing today would not cure the failure to hold a hearing prior to the issuance of the Restraining Order, it is nonetheless required.[2]

[2] Section 853(j) directs the Court to Title 21, United States Code, Section 881(d) which in turn refers to the Supplemental Rules For Certain Admiralty and Maritime Claims, Title 28 United States Code,

A hearing is also necessary to assess the propriety of the Restraining Order even with regard to the assets that are specifically enumerated in the Indictment under Section 853(e)(1)(A). In United States v. Thier, 801 F.2d 1463, 1468 (5th Cir. 1986), the Court of Appeals for the Fifth Circuit, faced with a restraining order entered pursuant to Section 853(e)(1)(A), held that "Rule 65 [of the Federal Rules of Civil Procedure] must be followed in connection with post-indictment pre-trial restraining orders." As the Thier court noted,

> "[u]nder Rule 65, an ex parte restraining order is effective for a maximum of ten days unless the court extends it for an additional ten day period for good cause shown, or unless the defendant consents to an extension. Prompt notice to the defendant and an adversary hearing must follow the order and precede the entry of an injunction that freezes the defendant's assets for any further period of time. The district court must hold a prompt hearing if the defendant moves to modify or dissolve a restraining order."

Id. at 1469. In reversing and remanding the district court's decision denying defendant's request for an adversary hearing, the Thier court noted that the requirements of Rule 65 do not "impair the court's power to refuse to look behind the indictment" or "require the Government to prove the merits of the underlying criminal case." Id. Rather, Rule 65 gives "the defendant an opportunity to be heard in a meaningful way at a meaningful time before he is denied the present use of property which may or may not prove to be forfeitable." Id. (citing Armstrong v. Manzo, 380 U.S. 545, 552 (1965)). See also United States v. Crozier, 777 F.2d 1376, 1382-83 (9th Cir. 1985).

The Court in Thier also considered the appropriate burden of proof at such a hearing. Referring to the four elements that a movant must demonstrate in support of a motion for a preliminary injunction, (1) a substantial likelihood that the Government will

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Appendix (the "Supplemental Rules"). The Supplemental Rules direct the Court back to Rule 65 of the Federal Rules of Civil Procedure which mandates that an adversary hearing be held.

ultimately prevail on the merits; (2) that the restraint is necessary to prevent irreparable injury; (3) that the threatened injury must outweigh the harm the restraint might do claimants; and (4) that the restraint must be consistent with the public interest, the Court held that "these requirements form an appropriate outline for the Government in a hearing pursuant to a Section 853(e)(1)(A) injunction request." Thier, 801 F.2d at 1470. During such a hearing, the grand jury's probable cause findings "are not irrebutable;" the Government must be able to demonstrate that the restrained assets are tainted and therefore forfeitable. Id. Noting that Section 853 is a "permissive" provision, the Court held that, after an adversary proceeding, the district court "is free, and indeed required, to exercise its discretion as to whether, and on to what extent to enjoin based on all matters developed at the hearing." Id.

Mr. Scrushy respectfully requests that the Government be put to its proof at an adversary proceeding as soon as is practicable.

C. The Government Had And Has No Basis For Asking This Court To Impose A Pre-Trial Restraint On Mr. Scrushy's Assets For The Purpose Of Preserving Funds To Satisfy A Potential Judgment

The Government simply and plainly may not restrain assets for which it has failed to make a sufficient showing of interest either through a properly enumerated Indictment or through some other probable cause showing. See Grupo Mexicano de Desarrollo, S.A. v. Alliance Bond Fund, Inc., 527 U.S. 308 (1999) ("GMD"). In GMD, the Court held that a federal district court does not have the power to restrain, prior to judgment, assets over which the party seeking the restraint does not have an equitable claim. GMD, 527 U.S. at 322-27. Rather, the equity powers possessed by the district court are limited to (1) those equitable powers exercised by the English High Court of Chancery at the time

the United States Constitution was adopted, and (2) the equitable powers that have since been expressly conferred by Congress. Id. at 318-22. Accordingly, a preliminary injunction or restraining order may only issue when a party who has asserted claims for equitable relief (i.e., a pre-trial freeze of assets), seeks to restrain the same *res* or thing that is the subject of its underlying claim. See GMD, 527 U.S. at 326-27. In other words, the district court is only empowered to prevent a defendant from using or transferring specific assets over which the plaintiff has claimed an equitable interest.

In GMD, holders of bonds issued by GMD commenced an action for breach of contract arising from GMD's alleged nonpayment of principle and interest. Id. at 312-13. Concerned that GMD was dissipating assets for the benefit of other creditors, the bondholders sought a preliminary injunction under Rule 65 of the Federal Rules of Civil Procedure preventing GMD from transferring certain assets located in Mexico. Id. The district court, predicating its decision on the inherent equitable powers of the court, issued an order preliminarily enjoining GMD from "dissipating, disbursing, transferring, conveying or otherwise distributing or affecting [GMD's] right to, interest in, title to, or right to receive or retain, any of [its assets]." Id. at 313. The United States Court of Appeals for the Second Circuit affirmed.

In reversing and remanding the decision below, the Court in GMD held that Rule 65 of the Federal Rules of Civil Procedure does not, in itself, confer any equitable powers on the district courts. Id. at 318-19. Instead, the Court stated that an independent basis for securing these assets had to exist. The Court held that, because the equity power of the English Court of Chancery did not extend to the issuance of a preliminary injunction for the purpose of preserving a pool of funds to pay a potential money judgment, the

Court ruled that such power could not be exercised by the federal district courts. GMD further holds that the risk that the defendant may dissipate assets or transfer assets outside the United States does not, in itself, give the district court the power to enjoin the defendant.[3]

In this present case, the Government's only equitable interest in assets properly supported by a grand jury indictment or through some other probable cause finding would be if a statute or decision gave the Government that interest. As demonstrated in Point II, D., *infra*, the statutes and decisions in the forfeiture arena give the Government an interest only in assets it can claim to be tainted. Many of the assets enumerated in the Indictment and in Attachment 1 have been restrained only for the purpose of securing them to satisfy a potential money judgment, i.e., a claim for fungible money damages as part of a verdict at trial. Accordingly, under GMD this Court lacks the equitable power to freeze those assets.

D. The Government Will Be Unable To Meet Its Burden Of Proof With Regard To Many Of The Assets Encompassed In The Restraining Order

With regard to many of the assets covered by the Restraining Order, including both those enumerated in the Indictment and those set forth in Attachment 1, the Government will be unable to meet its burden of demonstrating a relationship to the criminal activity alleged in the Indictment. Rather than seeking a carefully tailored restraint of assets as required by Section 853, the Government has instead employed a blunderbuss approach, seeking and obtaining a Restraining Order which curtails Mr.

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[3] Interestingly, in GMD, the United States submitted an *amicus* brief in support of the respondents, expressing concern that a decision limiting the court's equitable powers might impair law enforcement efforts in precisely the circumstances presented here. The Court was unmoved by the United States' concerns.

Scrushy's use or disposition of virtually all of the assets he has ever earned or acquired, without regard to whether those assets are derived from the proceeds of alleged criminal conduct. The Government's wholesale restraint of Mr. Scrushy's assets is also impermissible in the face of a prior judicial determination that at least $49 million of Mr. Scrushy's assets were derived from sources unrelated to HealthSouth. Having previously sought to restrain Mr. Scrushy's use of all of his assets and lost, the Government cannot now seek to revisit the issue. Even if the Government is permitted to disregard the estoppel effect of Judge Johnson's Opinion, as a factual matter the Government would be unable to demonstrate that all of the assets enumerated in the Indictment or otherwise covered by the Restraining Order are derived from the criminal acts alleged in the Indictment. Rather, the Restraining Order restricts Mr. Scrushy's use of "substitute assets" which are not properly restrained prior to a conviction. As such, the Restraining Order should be modified so as to release from its purview the assets that have been improperly restrained.

1. The Government Is Collaterally Estopped From Restraining $49 Million Of Mr. Scrushy's Assets That Have Been Previously Found To Be Untainted

The Government's restraint of the totality of Mr. Scrushy's assets is inconsistent with a finding of fact made by Judge Johnson in her opinion dismissing the Government's petition for an emergency freeze of Mr. Scrushy's assets. Accordingly, under the doctrine of collateral estoppel, the all-encompassing Restraining Order cannot stand.

After an eleven day hearing regarding the propriety of the Government's freeze of Mr. Scrushy's assets, Judge Johnson held that "[a]lthough not required to do so, defendant Scrushy proved that at least 49 million dollars of his assets since 1993 are not

derived from HealthSouth income, bonus or stock." HealthSouth Corp., 261 F. Supp. 2d at 1315. That finding of fact prevents the Government from restraining the $49 million in assets that Judge Johnson determined were untainted.

The doctrine of collateral estoppel prevents relitigation of an issue of fact or law that has been litigated and decided in a prior suit. It applies when (1) the issue at stake in a pending action is identical to the one involved in the prior litigation; (2) the issue was actually litigated in the prior suit; (3) the determination of the issue in the prior litigation was a critical and necessary part of the judgment in the action; and (4) the party against whom the earlier decision is asserted had a full and fair opportunity to litigate the issue in the earlier proceeding. Barger v. City of Cartersville Georgia, 2003 WL 22434723 (11th Cir. Oct. 28, 2003) (citing In re McWhorter, 887 F.2d 1564 (11th Cir. 1989)). As the Supreme Court held in Parklane Hosiery Co. v. Shore, 439 U.S. 322, 326 (1979), collateral estoppel serves "the dual purpose of protecting litigants from the burden of relitigating an identical issue with the same party or his privy and of promoting judicial economy by preventing needless litigation." All of the elements of collateral estoppel are present here.

First, the issue here and the issue presented to Judge Johnson are the same, i.e., whether the Government has met its burden of demonstrating that all of the assets it has restrained are traceable to alleged wrongful acts. Like the Government here, during the asset freeze hearing, "the SEC admitted . . . that it was not able to ascertain which of defendant Scrushy's assets, if any, are attributable to the ill gotten gains and therefore *all* of his assets should be frozen." HealthSouth Corp., 261 F. Supp. 2d at 1315 (emphasis in original). That issue was litigated in the asset freeze hearing through Mr. Scrushy's

proffer of witnesses and documents to support his contention that the SEC was unable to trace a substantial portion of his assets to alleged wrongful acts. See Transcript of Asset Freeze Hearing before the Honorable Inge P. Johnson at pp. 365:1-397: 25; 652:4-668:9. Judge Johnson's finding that the SEC failed to meet its burden of tracing the frozen assets to Mr. Scrushy's alleged wrongful conduct was, of course, essential to her ruling. See HealthSouth Corp., 261 F. Supp. 2d at 1330 (finding that the SEC had failed to meet its burden of establishing "even a reasonable likelihood of success on the merits. "). Finally, it is well settled that even distinct Government entities are viewed as one party for purposes of *res judicata* and collateral estoppel. Boone v. Kurtz, 617 F.2d 435 (5th Cir. 1980). As the Supreme Court held in Sunshine Anthracite Coal Co. v. Adkins, 310 U.S. 381, 402-03 (1940), "[t]here is privity between officers of the same Government so that a judgment in a suit between a party and a representative of the United States is *res judicata* in relitigation of the same issue between that party and another officer of the Government." See also Estevez v. Nabers, 219 F.2d 321 (5th Cir. 1955); United States v. Rogers, 960 F.2d 1501 (10th Cir. 1992). This is especially so because the Department of Justice was fully involved in the asset freeze proceeding, having filed motions to intervene on five separate occasions, asserting objections to defendant's cross-examination of Government witnesses and attending virtually every day of the hearing. HealthSouth Corp., 261 F. Supp. 2d at 1307-09.

The Government, having had the opportunity to litigate the question of which of Mr. Scrushy's assets could be traced to alleged wrongful conduct, cannot now challenge Judge Johnson's finding that at least $49 million in assets was untainted. Rather, if the Government disagreed with Judge Johnson's opinion, it could have sought appellate

review. It did not. Now, as part of its proof, the Government should be required to account for the $49 million which should be free from restraint.

2. Mr. Scrushy Acquired Substantial Assets That Are Not Traceable To The Criminal Acts Alleged In The Indictment

The Government cannot possibly demonstrate that all of the assets enumerated in the Indictment or covered by the Restraining Order are traceable to the criminal conduct alleged in the Indictment. To the contrary, although it is not his burden to do so, Mr. Scrushy can demonstrate that he accumulated substantial wealth prior to the time period alleged in the Indictment and accumulated additional wealth during the period alleged in the Indictment but that has no relation to the alleged wrongful conduct. As to the assets named in the Indictment, the Government will be unable to meet its burden under Rule 65, as set forth in Thier. Similarly, with regard to assets included in the Restraining Order but not named in the Indictment, the Government will be unable to meet its probable cause burden.

a. Mr. Scrushy Acquired Approximately $97 Million In Assets Prior To The Period Of Time Alleged In The Indictment

As set forth in the Affidavit of Byron Luke dated November 26, 2003 (the "Luke Aff."), Mr. Scrushy acquired approximately $97 million in assets prior to January 1, 1996, the earliest date of criminal activity alleged in the Indictment. Luke Aff. at ¶ 5. The assets accumulated by Mr. Scrushy prior to January 1, 1996 include real property, personal property, automobiles, watercraft, stocks, bonds and cash. Luke Aff. at Exhibit 1. All of these assets are encompassed by the Restraining Order. For example, Mr. Scrushy acquired real properties in Vestavia Hills, Alabama ("Longleaf Estates") and Ono Island, Alabama prior to 1990. Luke Aff. at ¶ 8. The Government will be unable to

demonstrate that those properties represent the proceeds of or are related to a criminal act because they were purchased more than six years prior to the period of alleged illegal activity covered by the Indictment. Similarly, brokerage accounts at SouthTrust Securities and Morgan Stanley, and a substantial sum in the Smith Barney account in Birmingham, among others, were funded with assets that long predated the allegations in the Indictment (Luke Aff. at ¶ 9; Exhibit 1) and cannot be restrained prior to trial.

b. Mr. Scrushy Acquired An Additional $79 Million In Assets During The Time Alleged In The Indictment From Sources Unrelated To The Subject Matter of The Indictment

Mr. Scrushy also acquired an additional $79 million dollars in assets since January 1, 1996 that are unrelated to the criminal activity alleged in the Indictment. Luke Aff. at ¶ 7. These assets include sales of options and founder's shares of company's other than HealthSouth, as well non-incentive based compensation received by Mr. Scrushy from HealthSouth between 1996 and 2002. Luke Aff. at ¶ 7. The Government will be unable to meet its burden of demonstrating that these assets are traceable to the substantive allegations set forth in the Indictment.[4]

3. The Government Has Improperly Restrained "Substitute Assets"

It is now clear that the Government's theory to restrain a substantial portion of the assets encumbered by the Restraining Order is that these would constitute "substitute assets." As stated above, "substitute" assets are not related to or arising from the criminal activity alleged in the Indictment but rather are those which the Government can seek for

[4] This is true even with regard to assets that Mr. Scrushy acquired before the alleged wrongdoing occurred but as to which value was added or subtracted during the period of alleged wrongdoing. The law requires that the Government trace "tainted" assets into otherwise "untainted" assets and gives the Government the right to restrain only that portion of the assets which is demonstrably tainted. The addition of tainted assets to untainted assets does not render the entire asset tainted. See, e.g., United States v. Najjar, 57 F. Supp. 2d 205 (D. Md. 1999).

the purpose of replacing or acting as a substitute for "tainted" property which has been transferred, lost, disposed of, or has diminished in value. See Section 853(p). While "substitute assets" may be forfeitable after a conviction, they cannot be restrained prior to judgment. Rather, Section 853(p) expressly contemplates that an order of forfeiture has already been entered against the asset that now cannot be found or is otherwise unavailable. Therefore, the restraint of substitute assets can only occur after a verdict and judgment is obtained.[5]

The plain language of the forfeiture statute invoked by the Government makes clear that the substitute assets provision, Section 853(p), applies only after conviction and then only to replace that which has been determined to be ill gotten gains under Section 853(a), but cannot be located. Section 853(p) provides that:

> "Forfeiture of Substitute Property
>
> (1) In general
>
> Paragraph (2) of the subsection shall apply, if any property described in subsection (1), as a result of any act or omission of the defendant
>
> (A) cannot be located upon the exercise of due diligence;
>
> (B) has been transferred or sold to, or deposited with, a third party;
>
> (C) has been placed beyond the jurisdiction of the court;
>
> (D) has been substantially diminished in value; or
>
> (E) has been commingled with other property which cannot be divided without difficulty.

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[5] Because the statutes do not give the Government any "right" to restrain substitute assets prior to verdict, they do not provide the Government with an "equitable claim" to freeze these assets under Rule 65 and the law on restraining orders. Because the Government does not have such an equitable claim, its Restraining Order violated the Supreme Court's decision in GMD, 527 U.S. 308. See Point II, C., *supra*.

Substitute Property

> In any case described in any of subparagraphs (A) through (E) of paragraph (1), the court shall order the forfeiture of any other property of the defendant, up to the value of any property described in subparagraphs (A) through (E) of paragraph (1), as applicable. "

This is not the first time the Government has tried to restrain untainted assets under the substitute asset theory prior to obtaining a conviction.[6] However its efforts have been routinely rejected by the federal appellate courts who have considered the issue. To date, the Second, Third, Fifth, Sixth, Eighth and Ninth Circuits have rejected the Government's effort to restrain substitute assets prior to a conviction. While the Fourth Circuit has allowed one type of pre-trial restraint of substitute assets, it did so only when the owner of the assets was a fugitive who had absconded with all of the tainted assets that were subject to forfeiture. See In re Billman, 915 F.2d 916 (4th Cir. 1990). In cases where such extraordinary facts did not exist, even courts within the Fourth Circuit have refused to permit the pre-trial restraint of substitute assets.[7] Moreover, the continuing vitality of the Fourth Circuit's decision is questionable in the aftermath of the Supreme Court's decision in GMD.

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[6] In fact, the Department of Justice has tried for years to gain legislation authorizing the seizure of substitute assets at the initiation of a prosecution. They have routinely failed in these efforts, including their most recent attempt in connection with the USA Patriot Act of 2001. See Smith, Prosecution and Defense of Forfeiture Cases, Section 13.02, p.13-40, n.81.1.

[7] In Najjar, the court stated that, "[w]hile the Billman court held that § 1963(d) *authorizes* pre-trial restraints on substitute assets, it did not address whether the statute *requires* such restraints. Najjar, 57 F. Supp. 2d at 208-09 (emphasis in original). The Najjar Court further asserted that "where the Defendant affirmatively acts to evade the reach of the forfeiture laws, the Fourth Circuit concluded that § 1963(d) should be read broadly to counter these attempts." Id. at 209. The court declined to restrain the substitute asset where the defendant made no affirmative attempt to evade forfeiture. Id. Most commentators and courts have agreed that Billman was a decision founded on the extreme conduct of the fugitive involved and thus should not be applied to less egregious facts. See, e.g., David B. Smith, Prosecution and Defense of Forfeiture Cases § 13.02, at 13-39 – 13-40 n. 81 ("Hard facts make bad law").

While the Eleventh Circuit has not directly addressed the issue, the Fifth Circuit has ruled that the pre-trial restraint of substitute assets is impermissible.[8] See United States v. Floyd, 992 F.2d 498 (5th Cir. 1993). In Floyd, the Fifth Circuit soundly rejected the Government's argument that Section 853 permits pretrial restraint of substitute assets. The court noted that Section 853(a) does not include substitute assets, but rather that Congress treated substitute assets in a different section of the statute (Section 853(p)), and to allow the Government to freeze "untainted assets would require us to interpret the phrase 'property described in subsection(a)' to mean property described in subsection (a) *and (p)*." Floyd, 992 F.2d at 502 (emphasis in original). The Fifth Circuit declined to do this noting that, although the statute commands a liberal interpretation, it "does not authorize us to amend by interpretation." Id. As recently as May 2003, the Sixth Circuit endorsed the Fifth Circuit's analysis set forth in Floyd, awarding prejudgment interest to the defendant as a result of the Government's wrongful pre-trial restraint of untainted assets even though the defendant was ultimately convicted on numerous counts. See United States v. Ford, 2003 WL 21212547 (6th Cir. May 22, 2003).

The Second Circuit also agreed with the Fifth Circuit's decision in Floyd, holding that the statute provides that substitute assets may not be restrained prior to trial and noting that "nothing in the legislative history requires a different result." United States v. Gotti, 155 F.3d 144, 149 (2d Cir. 1998).[9] The Third Circuit has determined that

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[8] Because of their common history, the Eleventh Circuit has held that it can look to precedents within the Fifth Circuit for guidance. See Bonner v. City of Prichard, 661 F.2d 1206 (11th Cir. 1981).

[9] The Second Circuit's opinion in United States v. Regan, 858 F.2d 115 (2d Cir. 1988) has been mistakenly interpreted as applying to all pretrial restraints of substitute assets, but the Second Circuit subsequently clarified that its opinion in Regan only dealt with the limited issue of pretrial restraint of racketeering proceeds, "not substitute assets." United States v. Gotti, 155 F.3d 144 (2d Cir. 1998). In Gotti, the Court said that to the extent Regan made any statements about substitute assets, such statements were beyond the circumstances of the case and do not rule. The Gotti Court goes on to join the majority view that substitute assets are not subject to pretrial restraint.

forfeiture of substitute assets is impermissible under 18 U.S.C. § 1963.[10] See In re Assets of Martin, 1 F.3d 1351, 1359 (3rd Cir. 1993) (holding that because the restraints provision of § 1963(d)(1) does not mention the substitute assets provision, § 1963 does not permit pretrial restraint of substitute assets). Similarly, the Eighth and Ninth Circuits have ruled that pretrial restraints on substitute assets are unavailable under 18 U.S.C. § 982. See United States v. Riley, 78 F.3d 367, 371 (8th Cir. 1996) (relying on United States v. Field, 62 F.3d 246 (8th Cir. 1995) (employing a literal interpretation of § 1963 does not authorize pretrial restraint of substitute assets)); United States v. Ripinsky, 20 F.3d 359, 363 (9th Cir. 1994) (holding that to allow an interpretation of § 1963 would be "clearly contradictory to the plain statutory language" and amount to an "amend[ment] by interpretation").

Considering the overwhelming authority proscribing the pretrial restraint of substitute assets, this Court should modify the Restraining Order to exclude all assets that have been improperly encumbered as substitute assets.

[10] The substitute assets provision found in the RICO statute, 18 U.S.C. § 1963(m), is identical to Section 853(p).

CONCLUSION

Mr. Scrushy does not contest the Government's power to freeze before trial that which the law allows, but he strongly opposes the Government's misapplication of the statute and the conflation of pre-indictment and post-indictment provisions to deprive him of effectively all of his property. That process not only violates the statutory scheme, but it has also resulted in an unconstitutional interference with property. For all the foregoing reasons, the Restraining Order should be modified to exclude: (1) all assets not specifically enumerated in the Indictment, and (2) assets not properly restrained because they were (a) acquired prior to the period of illegal activities alleged in the Indictment, (b) acquired as the results of activities unrelated to the allegations set forth in the Indictment or (c) have been restrained as substitute assets.

By Abbe David Lowell/S.S.B.

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Counsel for Defendant Richard M. Scrushy

IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF ALABAMA
SOUTHERN DIVISION

UNITED STATES OF AMERICA,

v.

Case No. CR-03-BE-0530-S

RICHARD M. SCRUSHY,

Defendant.

AFFIDAVIT OF BYRON B. LUKE

Alabama, Jefferson County

1. My name is Byron B. Luke. I am of legal age, laboring under no disabilities and otherwise competent to testify to all the matters set forth herein, all of which are within my personal knowledge.

2. I am a Managing Associate of FCL Advisors, Int'l, LLC, a Virginia Corporation engaged in the business of providing forensic accounting services. I am a licensed Certified Public Accountant in the State of Texas. I have more than twenty years experience in public industry accounting, including tax accounting and investigative auditing.

3. FCL Advisors, Int'l, LLC, has been retained by Mr. Scrushy through his legal counsel to gather and review financial records relating to the charges lodged by the Department of Justice (hereafter the Government) against Mr. Scrushy including the forfeiture allegations contained in the Indictment.

4. In performing my work, I have reviewed the financial position of Mr. Scrushy as of December 31, 1995, that is, his financial standing prior to any alleged illegal conduct as set out in the Indictment. I have also reviewed significant transactions since December 31, 1995 to determine the extent to which Mr. Scrushy's wealth as of November 15, 2003 is attributable to (1) pre-1996 wealth, (2) proceeds from transactions unrelated to Healthsouth, or (3) ordinary salary from Healthsouth. More simply, I have performed a review to determine what, if any, of his current wealth is attributable to transactions unrelated to the fraud alleged in the Indictment filed against Mr. Scrushy (the Indictment).

5. Based upon my review of financial records to date, I have been able to conclude with reasonable degree of forensic accounting certainty that much of Mr. Scrushy's current wealth derives from property that he owned prior to 1996. Mr. Scrushy's pre-1996 net wealth was approximately $97 million and consisted, at least in part, of the wealth specifically set out in Exhibit 1 which is attached to this affidavit.

6. Additionally, much of Mr. Scrushy's current wealth and property was derived from earnings and transactions occurring after December 31, 1995, which have nothing to do with the criminal conduct alleged in the Indictment.

7. Mr. Scrushy earned significant income from transactions not involving HealthSouth, and also earned substantial regular, non-bonus compensation. Income derived from these sources, activities which are not related to the fraud alleged in the Indictment, total approximately $79 million and was composed of the following items:

- $14 million in proceeds derived from the sale of Health Realty Trust stock and from a related non-compete agreement in the years 1998 through 2002.

- $35.5 million was realized from the sale of Caremark RX stock and related options in the years 2000 and 2001. Many of the Caremark shares were founder's shares owned by Mr. Scrushy prior to December 31, 1995, and the related options had been issued to Mr. Scrushy for serving as a temporary Chairman and CEO of Caremark RX in 1999.
- $3.3 million of proceeds were derived from the sale of Scandipharm stock in the years 1997 and 1999. These shares were acquired in 1991 and 1992.
- $3.7 million was realized from the sale Capstone Capital stock in the year 1998. These shares had been acquired and held by Mr. Scrushy since 1993.
- $22 million in proceeds were derived from non-bonus salary received for work as CEO for Healthsouth over the years 1996 through 2002.

Direct Tracing Analysis

8. Much of Mr. Scrusy's current wealth is directly traceable to assets that he owned prior to any alleged criminal conduct. Specifically, Mr. Scrushy's personal residence (Longleaf), currently valued at approximately $5 million, was acquired in 1989. Likewise, his residence on Ono Island, valued at approximately 1.5 million, was acquired in 1988, long before the time period alleged in the Indictment.

9. Mr. Scrushy's Healthsouth stock, valued currently at approximately $6.5 million, was acquired before December 31, 1995, and still remains in an account at the same brokerage firm of Salomon Smith Barney as it did as of December 31, 1995.

10. Certain of Mr. Scrushy's current wealth is directly traceable to non-Healthsouth-related transactions that occurred during the period from January 1, 1996 to present. A non-exhaustive set of examples include the following:

- Mr. Scruchy directly invested approximately $4 million in proceeds from the sale of Caremark stock (unrelated to Healthsouth) in the purchase of the Chez Soiree yacht in 2001.
- Mr. Scurshy has also realized at least $34 million in net, after tax, proceeds from other non-Healthsouth-related transactions for which I have been able to trace the funds directly into accounts that have been seized in their entirety by the Government. The gross amounts for these assets are set out in paragraph 7 above.

11. My review of the various investment and banking accounts has revealed that, consistent with ordinary and ethical standards for maintenance of personal and business affairs, Mr. Scrushy used his personal bank account, money market accounts, various brokerage and real estate accounts to both maximize returns, and to make available certain operating account balances to pay taxes, make philanthropic contributions and pay bills in the normal course.

12. As a consequence, a substantial portion of the proceeds that the Government has now seized is (1) either property that existed long before the alleged illegal activity set out in the Indictment, (2) property that can be clearly traced to transactions that have nothing to do with Healthsouth, or (3) property that has, through ordinary personal and business transactions, been commingled with property that has nothing to do with the alleged criminal violations.

13. Based upon my review of the accounts and various transactions, it is my professional opinion that, based upon a thorough review of the financial and business practices of Mr. Scrushy, there has been no effort whatsoever to intentionally mix allegedly ill-gotten gains with gains and proceeds from transactions that have nothing whatsoever to do with the allegations in the Indictment.

Pursuant to Title 28, United States Code, Section 1746, I certify under the penalties of perjury that the contents of the foregoing are true to the best of my knowledge, information and belief.

This 26 day of November, 2003.

Byron B. Luke

RICHARD M. SCRUSHY
Assets on December 31, 1995

	Amount
Cash	
AmSouth PFS	776,000
Brokerage Accounts	
Solomon Smith Barney - NY	31,044,547
Solomon Smith Barney - Birmingham	631,589
AG Edwards	209,306
Andrew Lanyi - Oppenheimer	780,000
Alex Brown	28,750
Morgan Stanley - Forstmann-Leff	1,401,064
Merrill Lynch - Jeff Collier	222,000
Long Term Bond Portfolio	
AmSouth Trust	2,200,000
Venture Capital Investments	
Scandipharm	815,217
Omega Pharmiceutical	77,766
Frontline Capital	25,000
Frontenac Partners IV - audited f/s KMPG	63,891
Americaid Investment	40,000
Partners in Progress	50,000
Other Investments	
Oil Well Investments	100,000
H/S Stock Options	50,473,873
Real Estate and Personal Property	
Longleaf Estate	5,500,000
Ono Island	800,000
50% Key Colony Beach	230,000
50% of Rocky Ridge	150,000
Grady Ala Property	150,000
Autos	400,000
Boats	100,000
Other Personal Property	1,500,000
Portion of Assets as of December 31, 1995	97,769,003

FCL

Exhibit 1 to the Affidavit of Byron B. Luke

IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF ALABAMA
SOUTHERN DIVISION

UNITED STATES OF AMERICA,

v.

Case No. CR-03-BE-0530-S

RICHARD M. SCRUSHY,

Defendant.

CERTIFICATE OF SERVICE

I certify that I have this day, November 26, 2003, served a true and correct copy of the foregoing Motion to Modify the Court's Restraining Order Dated November 3, 2003, upon the United States Government and their counsel by hand delivery to the office of the United States Attorney in Birmingham, Alabama to the attention of the following government lawyers:

Alice Martin, United States Attorney
Richard C. Smith, Deputy Chief, Fraud Division
Michael Rasmussen, Assistant United States Attorney
James Ingram, Assistant United States Attorney

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